IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1945

No. [redacted] 133

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

WILLIAM S. KLEINMAN,
One North LaSalle Street,
Chicago 2, Illinois,
Counsel for Petitioner.

PRINTED BY CHICAGO LAW PRINTING CO.

INDEX.

Subject Index.

Table of Cases Cited.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1945

No.

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable the Justices of the Supreme Court of the United States:

The petition of John H. Chatz, Trustee in Bankruptcy of Hoagland & Allum Co., Inc., prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit which affirmed the findings and judgment of the District Court of the United States for the Northern District of Illinois, Eastern Division, dismissing petitioner's complaint against the respondent, Midco Oil Corporation, at this petitioner's costs.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The petitioner is the Trustee in Bankruptcy of Hoagland & Allum Co., Inc., a stock brokerage concern which operated on La Salle Street, in the City of Chicago, for many years before it was adjudicated a bankrupt, on April 14, 1938. Shortly after the adjudication in bankruptcy, the officers of the bankrupt company were prosecuted and convicted under Federal and State charges for various wrongs committed against its customers in converting and hypothecating their respective securities. The total defalcations amounted to approximately $500,000.00 (Rec. 210).

About the time these officers were scheduled to be released from their incarceration, the Trustee filed his complaint against them and others for discovery of assets and accountings. As the result of disclosures thus obtained, the respondent, Midco Oil Corporation, was made a party defendant (Rec. 8), and a supplemental complaint for discovery of assets and for accountings was thereupon filed against said respondent (Rec. 9). The respondent is a Delaware Corporation licensed to do business in Oklahoma and maintains its head office in Tulsa, Oklahoma.

Briefly stated, it is charged in the supplemental complaint (Rec. 9-14), that during the month of August, 1937, the bankrupt stock broker had carried on a series of negotiations with one Roy Mead, a resident of Tulsa, Oklahoma, with the view of having him acquire the majority of the outstanding stock of the respondent, Midco Oil Corporation, at the price of $43.00 per share; that bankrupt circularized its list of customers who were owners of Midco Oil Corporation stock urging them to make deposit of their respective shares with a designated depository, for that purpose. In consequence of such circularization some stock-

holders sent their certificates of stock to the depositary; however, a number of bankrupt's customers brought their shares to the bankrupt for that purpose, with the result that 2,000 shares of this stock belonging to its customers came into or was then in the bankrupt's possession. The complaint further charges that in consequence of secret negotiations which were then undertaken and carried on between the officers of the bankrupt and this respondent, the said respondent, on September 3, 1937, fraudulently purchased from the bankrupt the said 2,000 shares of respondent's capital stock, the property of its stockholders (Rec. 12), at the price of $33.50 each share, or a total sale price of $67,000.00; that after the payment of $2,000.00 to the respondent's intermediary in this transaction, the balance of $65,000.00 was transmitted and paid over to the bankrupt, who converted the proceeds. The supplemental complaint further charges that this respondent then had full knowledge of the bankrupt's communications and negotiations with respondent's stockholders, and of the contemplated sale of the controlling stock to Roy Mead at $43.00 each share, that it made no inquiry as to the bankrupt's authority to make said sale to this respondent, nor did it make inquiry from any of the said stockholders as to the bankrupt's authority to sell their respective shares of stock, and that the conduct of the respondent in thus purchasing these shares of stock is therefore tantamount to fraud (Rec. 12). This supplemental complaint prayed that the Court find and adjudge the acts and conduct of this respondent in purchasing the said 2,000 shares of its corporate stock to be fraudulent and illegal and that this respondent be decreed and directed to pay over to plaintiff, as such Trustee in Bankruptcy, the actual value of these 2,000 shares of stock, together with legal interest from the date of such fraudulent purchase. This sworn supplemental complaint also contains a prayer for general relief (Rec. 14).

The unsworn answer of this respondent (Rec. 30-35) admits that it is a Delaware Corporation with its principal place of business in Tulsa, Oklahoma, and admits the purchase of these 2,000 shares of its capital stock (Rec. 31), through Mr. Lahman, the same intermediary in Tulsa, Oklahoma, as charged in the complaint (Rec. 32), but states that in the making of said purchase it was "in the exercise of due care, caution and diligence" (Rec. 33). The respondent further avers that its purchase was effectual under The Stock Transfer Act of Illinois and under the pertinent laws of Oklahoma (Rec. 34). A number of factual matters are pleaded in the answer to negative the charge of fraud, and a number of technical defenses are alleged which are not deemed pertinent at this time. This respondent admits in its answer that after it purchased these 2,000 shares of stock, it cancelled these shares and issued a new certificate of 2,000 shares to itself, in its own name (Rec. 35).

The dispute in this record turns on the legal effect of this stock purchase, the purpose therefor and the circumstances surrounding the purchase of these shares of its capital stock, although there is no controversy that this stock purchase was made by the respondent from the bankrupt at the time, for the price and substantially in the manner as charged in the supplemental complaint. The only corporate authority for making this purchase, which respondent produced, is a resolution passed at a special meeting of its Board of Directors, held at Tulsa, Oklahoma, on August 14, 1937, under and by which the Board of Directors authorized the corporation "to purchase as much as 5,500 additional shares of the outstanding stock of the Midco Oil Corporation for The Corporation. This stock to be obtained at the present market price which is from $28.00 to $35.00 per share. This stock after purchasing, is to be put in The Treasury of the Company and known as Treasury Stock" (Rec. 303). The secret letter

of instructions which were given by Mr. Lahman, the respondent's intermediary, to the bank which received and turned the stock over to respondent, is in the record (Rec. 386). Mr. Toomey, respondent's president (one of the three members of its Board of Directors) was at the bank when this letter of instructions and the checks for $67,000.00 were turned over to an officer of the bank (Rec. 247).

The record discloses that a short time before this sale, Henry A. Engel, the bankrupt's secretary, fraudulently transferred 1400 shares of this stock into his name (Rec. 205, 207, 301), and that he made loans on the collateral of this stock (Rec. 371, 374, 375, 376, 377). Engel admitted that these stocks belonged to customers of the bankrupt (Rec. 206); the Court accordingly found that substantially all of these shares of stock belonged to customers of the bankrupt and that they received none of the proceeds of this sale (Rec. 427).

The record further discloses that the respondent then had issued and outstanding a total of 36,575 shares (Rec. 240). Mr. Toomey negotiated for this stock purchase (Rec. 239). Toomey testified that his salary as President of this company had been materially increased, that he then owned approximately 2,500 shares of this stock and that he did not want the Mead deal to go through (Rec. 244). Toomey admitted that he received a copy of the circular letter sent out by the bankrupt to respondent's stockholders requesting deposits of stock for the purpose of the Mead deal (Plaintiff's Ex. 68, Rec. 319), and that he countered this by immediately sending out his letter to the stockholders urging them not to deposit their stock (Plaintiff's Ex. 73, Rec. 325). Toomey further admitted that in answer to an inquiry by one of the owners of several certificates of stock which were included in this purchase, he sent a reply which contained misinformation as to the identity of the purchaser of those shares of stock (Rec. 259, 353). Toomey

further testified that he did not inform the stockholders of this purchase (Rec. 260).

The Circuit Court of Appeals in affirming the District Court held that petitioner is precluded from relying upon the Oklahoma Statute which specifically prescribes the circumstances and manner for purchasing its capital stock by the issuing corporation; that the respondent and its officers did not owe a fiduciary duty to its stockholders whose shares it had thus purchased, and the Court treated this purchase as falling within the protection of the Uniform Stock Transfer Act. The Circuit Court of Appeals did not review the record *de novo,* but accepted the findings as made by the District Court, despite the fact that this is an equity proceeding.

There was no unanimous consent or other authorization by the respondent's stockholders to make the purchase in question and no resolution or other writing to that effect was ever presented to the stockholders; in fact no unanimous written consent of its stockholders to make this purchase, as the Oklahoma statute requires, was ever procured. The record discloses from the testimony of Mr. Toomey, the president of the respondent company, that the $67,000.00 which paid for the stock and the intermediary's brokerage came from the respondent's operating capital (Rec. 227). The respondent then had no surplus capital, but on the contrary, it had a very substantial deficit; this appears from the two financial reports introduced into evidence by the respondent as its Exhibits 62 and 63 (Rec. 387, 397). These exhibits disclose that respondent's deficit on December 21, 1936, before this purchase, was $954,696.71 (Rec. 392) and on December 31, 1937, after it made this purchase of stock, its deficit was $862,379.52 (Rec. 398). Under these established circumstances, as it will presently be shown in the brief following, the controlling statutes of Oklahoma and Delaware were clearly violated by the respondent; the transaction under discussion is therefore *ultra vires,*

and should have been so adjudicated by the Circuit Court of Appeals.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in 152 F. (2d) 153, and appears at pages 447 to 451 in the record.

STATEMENT AS TO JURISDICTION.

The judgment of the Circuit Court of Appeals was entered December 1, 1945 (Rec. 452), rehearing denied January 5, 1946 (Rec. 371). The jurisdiction of this Court rests on Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A. Section 347).

QUESTIONS PRESENTED.

1. Should not the Circuit Court of Appeals have taken judicial notice of the respective statutes which control the right of the respondent as the issuing corporation, to purchase its capital stock, and which specifically defines the limited conditions under which such purchase can be made?

2. Is it not the duty of a Court of Equity to rigidly enforce paternalistic statutes which govern, define and prescribe the circumstances and manner of making purchases of its capital stock by the issuing corporation?

3. Was not the respondent as the purchasing corporation required to affirmatively establish its compliance with the statutes of the state of its creation (Delaware), as well as of the state in which it does business and where it consummated the purchase of this stock (Oklahoma), which statutes regulate such purchases of capital stock?

4. Can the respondent ignore the statutes which regulate the manner of making stock purchases by the issuing corporation and at the same time be permitted to prevail

under its defense that it acted with "diligence" and in "good faith"?

5. Were the provisions of the Uniform Stock Transfer Act of Illinois properly applied by the Court as a defense to this purchase which is admitted to have been consummated in Oklahoma by a Delaware Corporation, in preference to the applicable statutes of those states?

6. Did not the respondent and its officers owe a fiduciary obligation to its stockholders not to buy their stock certificates secretly, in violation of the statutes and established law, but to zealously protect them and their interests in their stock in any manner reasonably possible; and does not an obvious breach of such duty create an obligation on the corporation to repay to the stockholders the loss thus sustained by them?

7. Disregarding the fiduciary relationship which existed between the parties, does not the common law rule apply in a state which has not adopted the Uniform Stock Transfer Act, so that the owners of endorsed stock certificates which have been stolen can recover them or their value, even though the one in possession of such stock certificates may appear to be a bona fide purchaser for value, without notice of the existing infirmities in title?

8. Was not the disrupting of the then contemplated plan to sell the controlling interest in this corporation to Roy Mead and to thereby retain control thereof for Toomey, its president, the real purpose for making this secret, illegal and unconscionable stock purchase?

9. Does not the misleading reply which Toomey sent to the owner of several certificates of this secretly purchased stock, shortly after its acquisition, establish strong evidence of wrongful knowledge on his part, at the time of purchase, which is imputed to the corporation?

10. Did not the respondent's purchase of this stock from the bankrupt at the price of $32.50 each share with knowl-

edge that its stockholders were then being urged to deposit their stock for sale at $43.00 per share constitute notice or knowledge that the bankrupt had no authority to sell its customers' stocks at a substantially lesser price, and that such notice prevented the respondent from acquiring indefeasible title to this stock?

11. Does not the fact that within about eight days after the respondent corporation cautioned its stockholders in writing not to deposit their shares of stock in connection with the Mead deal, it nevertheless undertook to negotiate with the bankrupt for the purchase of this block of stock, *ipso facto* establish a *prima facie* case of fraud in intent, purpose and in the consummation of this purchase?

12. Does not an appeal in an equity proceeding necessarily result in a trial *de novo* on the whole record, in the Circuit Court of Appeals, and in this Court?

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Circuit Court of Appeals is based upon a misinterpretation and misapplication of this Court's decisions in *Securities and Exchange Com.* v. *Chenery Corporation*, 318 U. S. 80, and *Pepper* v. *Litton*, 308 U. S. 295.

2. The Circuit Court of Appeals failed to take judicial notice of and give due effect to Sec. 19, Chapt. 65 of the Revised Code of Delaware, and Sec. 58, Title 18 of the Statutes of Oklahoma, which statutes define the manner, purpose and circumstances under which respondent could purchase its shares of capital stock.

3. The Circuit Court of Appeals failed to give due effect to applicable and controlling state statutes, statutory provisions and established common law principals and the supporting decisions of Courts of review which define the rules determining the disposition of this character of proceeding.

4. In failing to find and determine the existence of a fiduciary relationship between the respondent and its stockholders whose shares of stock it thus purchased from the bankrupt, and in failing to hold that the respondent and its president violated such duties to its stockholders in making this secret purchase, which violation of duty consequently voided this purchase, the decision of the Circuit Court of Appeals is in conflict with the great weight of authority.

5. In failing to recognize its obligation to try this equity cause *de novo* on the entire record, the Circuit Court of Appeals departed from the accepted and usual course of judicial proceedings as outlined by this court in *Keller* v. *Potomac Electric Co.*, 261 U. S. 428 (at page 444), 43 S. Ct. 445, 449, 67 L. Ed. 731.

Wherefore, your petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in Cause No. 8679, entitled *"John H. Chatz, Trustee in Bankruptcy of Hoagland & Allum Co., Inc., Plaintiff-Appellant* v. *Midco Oil Corporation, a corporation, Defendant-Appellee"*, and that the said order and judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be reviewed and reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

John H. Chatz, Trustee in Bankruptcy
of Hoagland & Allum Co., Inc.,
Petitioner,

By: William S. Kleinman,
Counsel for Petitioner.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1945.

No. ....

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in 152 F. (2d) 153, and appears at pages 447 to 451 in the record.

STATEMENT AS TO JURISDICTION.

The judgment of the Circuit Court of appeals was entered December 1, 1945 (Rec. 452), rehearing denied January 5, 1946 (Rec. 471). The jurisdiction of this Court rests on Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A. Section 347).

STATEMENT OF THE CASE.

A statement of the matter involved has been fully presented in our petition and the Court is respectfully referred to pages 2 to 7 herein. In the interest of brevity the statement is not repeated here.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals for the Seventh Circuit erred in the following respects:

1. In determining that the sale of the stock in question was valid.

2. In failing to take judicial notice of the statutes of Delaware and Oklahoma regulating the purchases of its capital stock by a corporation subject to the laws of those states, and in failing to apply and enforce said statutes as applicable to this proceeding.

3. By failing to determine that said purchase of stock by the respondent was contrary to law, *ultra vires* and void.

4. By failing to hold that the respondent corporation and its president owed to the owners of said stock the fiduciary obligation not to injure their property rights in said stock and not to purchase said shares of stock in violation of such duty.

5. In holding that no fiduciary duty was owed by the president of the respondent corporation to the stockholders when making said purchase.

6. In adjudicating that said stock purchase was valid under the Illinois Uniform Stock Transfer Act and under the laws of Oklahoma.

7. By failing to apply the common law rule to this transaction which makes the shares of stock in question recoverable by petitioner on behalf of the true owners thereof.

8. By deciding this case contrary to the weight of authority and the established rules of law and equitable principles applicable thereto.

9. By failing to reverse the judgment of the District Court, as is justified by the facts, equitable principles and the law applicable thereto.

SUMMARY OF ARGUMENT.

I.

The Circuit Court of Appeals was obliged to take judicial notice of the statutes of Delaware and Oklahoma and to decide this case in conformity with the requirements of those statutes.

II.

By virtue of the statutes of Delaware and Oklahoma the purchase of capital stock by the issuing corporation could be accomplished only out of surplus profits or by the unanimous written consent of the respondent's stockholders. As this purchase was made without the unanimous written consent of the stockholders and actually without any notice to them, and was paid for with operating capital while the corporation had an admitted deficit of almost a $1,000,000.00, the purchase was contrary to the statutes, in violation of public policy, and was *ultra vires* and void.

III.

The Circuit Court of Appeals failed to note the factual distinctions between this case and *Securities and Exchange Com.* v. *Chenery Corporation,* 318 U. S. 70, in citing that case as authority for its erroneous conclusion that no fiduciary relationship then existed between the respondent and its stockholders which would bar the respondent from making this purchase from the bankrupt. The transaction here under attack could not be regarded as bona-fide or valid under any accepted rule of law, for the purchase

was accomplished in a surreptitious manner, through an intermediary and at a price substantially less than was known to have been communicated to the stockholders, with knowledge of the fact that the stockholders were being urged to deposit their stock for sale to Roy Mead at a higher price, and this purchase was made for the sole purpose of interfering with that transaction so as to protect the president's position in the respondent's company, with no thought given to the essential statutory requirements and the rights of the stockholders whose shares of stock the respondent was thus purchasing.

As a fiduciary, the respondent had the burden of proving fair dealing towards its stockholders, and a valid purchase, in accordance with all legal requirements; this it failed to do and the Circuit Court of Appeals was obliged to hold that it failed to maintain its defense.

IV.

As the Uniform Stock Transfer Act of Illinois has no extraterritorial application, that statute cannot be urged as a defense to this void sale of stock of a Delaware corporation which was consummated in the state of Oklahoma, where neither Delaware nor Oklahoma has adopted such an Act, so that this statute obviously could not apply to this purchase. In the states of Oklahoma and Delaware the common law rule must necessarily prevail which protects the true owner of stock from loss thereof by theft, even though the shares of stock had been found in the hands of a bona fide purchaser, which the respondent was not. The Circuit Court of Appeals should have reviewed the entire record and should have held this rule to be applicable to the facts in this case and consequently should have awarded recovery to this petitioner. The correct application of the Illinois statute to the facts in this case would, in any event, have required the Court to award recovery to this petitioner.

ARGUMENT.

I.

By virtue of the "Uniform Judicial Notice of Foreign Law Act" of Illinois, and the pronouncements by this Court, the Circuit Court of Appeals was required to take judicial notice of the statutes of Delaware, as well as the statutes of Oklahoma.

This court said in *Mills* v. *Green,* 159 U. S. 651, at page 657:

> "The lower courts of the United States and this court, on appeal from their decisions, take judicial notice of the constitution and public laws of each state of the Union." (Citing cases.)

In *Adam* v. *Saenger,* 303 U. S. 59 (82 L. Ed. 649, 58 S. Ct. 454) this Court said at page 63:

> "Where they are in issue this Court, in the exercise of its Appellate jurisdiction to review cases coming to it from state courts, takes judicial notice of the law of the several states to the same extent that such notice is taken by the court from which the appeal is taken."

In *Loree* v. *Abner,* 57 Fed. 159 (C. C. A. 6), the court said on page 164:

> "The Federal Courts take judicial knowledge of the laws of the several states of the Union."

Wigmore on Evidence, Third Edition—Section 2573, page 556, states the rule as follows:

> "Since the judicial powers of the Federal Courts extend to many cases arising under the laws of the various States of the Union, such *State laws* are for

the purpose in hand part of the law of the *Federal Courts,* and will therefore be noticed by them."

Section 48g, Chapter 51, Illinois Revised Statutes 1945 provides as follows:

> "(Judicial Notice) Every court of this state shall take judicial notice of the common law and statutes of every state, territory and other judisdiction of the United States."

This Illinois statute, which is the law of judicial notice of the forum, necessarily requires all the courts of that state to take judicial notice of the statutes of every state, and applies with equal force to the Federal Courts in that state and to courts of review, as announced in the authorities hereinabove quoted.

It is axiomatic that judicial notice of facts takes the place of proof and is of equal force; it displaces evidence since it stands for the same thing. The Circuit Court of Appeals was unquestionably required to take judicial notice of these statutes of Delaware and Oklahoma and clearly erred in failing to do so.

II.

The purchase of its capital stock by the issuing corporation in any manner other than as permitted by statute, is ultra vires and void.

Section 19, (2051) Chapter 65 of the Revised Code of Delaware provides that:

> "Every corporation organized under this Chapter shall have the power to purchase, hold, sell and transfer shares of its own capital stock: Provided that no such corporation shall use its funds or property for the purchase of its own shares of capital stock when

such use would cause any impairment of the capital of the corporation, * * *."

The Circuit Court of Appeals for the Third Circuit construed a corporation's power under the above quoted Delaware Statute, in *Acker* v. *Girard Trust Co.*, 42 F. (2d) 37, where the court said on page 40:

"The company has no surplus, and therefore, as a Delaware corporation, its powers are fixed by the laws of that state (citing Delaware Statute).

"Construing such statute the Court of Chancery of Delaware held in *Re International Radiator Company*, 10 Del. Ch. 358, 92A 255, such stock purchases could only be made out of a corporation's surplus.

"Moreover, this court, in *West Penn Chemical & Manufacturing Company* v. *Prentice*, 236 F. 891, 894, said:

'We think it our duty to follow this decision upon the construction and effect of the Delaware statute, and we find it a controlling authority in the present case.' "

In construing a similar restriction contained in the Statutes of West Virginia, Circuit Judge Northcott said in *United Thacker Coal Co.* v. *Peytona Lumber Co.*, 15 F. Supp. 40, at page 44:

"The Trust Company [the seller] is charged with the knowledge of the law governing a corporation in the state in which it is incorporated, and therefore knew that, if the purchase of the stock impaired the capital of the corporation, it was in violation of the statute and *ultra vires*. *In re International Radiator Co.* 10 Del. Ch. 358, 29 A 255; *McCormick* v. *Market National Bank,* 165 U. S. 538, 17 S. Ct. 433, 41 L. Ed. 817, 3 Thompson on Corporations, Sec. 1795."

on page 45 the Court said:

"The purchase of the stock was in violation of the statute, *ultra vires,* and consequently void."

Section 58, Title 18, of the Statutes of Oklahoma, is as follows:

> "A corporation may purchase, hold and transfer shares of its own stock, from its surplus profits, or by the unanimous consent in writing of all its stockholders, in such manner and for such price or consideration as the said stockholders may unanimously decide upon."

The Supreme Court of Oklahoma enforced these rules in *Capitol Hill Undertaking Co.* v. *Render*, 299 Pacific 854, where the Court said on page 859:

> "A corporation 'may purchase, hold and transfer shares of its own stock, from its surplus profits, or by the unanimous consent in writing of all its stockholders, in such manner and for such price or consideration as the said stockholders may unanimously decide upon.' Section 5329 C. O. S. 1921. There is nothing in this record to show any surplus profits or unanimous consent in writing of the stockholders either to purchase or hold shares of its own stock. The corporation was without authority of law either to purchase or hold the shares of stock belonging to the plaintiff * * *."

Section 44 of Article IX of the Constitution of the State of Oklahoma provides:

> "§ 44 (Foreign corporations subject to same restrictions and requirements as domestic corporations). —No foreign corporation shall be authorized to carry on in this state any business which a domestic corporation is prohibited from doing, or be relieved from compliance with any of the requirements made of a similar domestic corporation by the Constitution or laws of the State."

In *18 C. J. S.*, Sec. 399, page 940, the following pertinent rule is stated:

> "The requisite and validity of a transfer of corporate stock are governed by the law of the domicile

of the corporation, although the transfer is made in another jurisdiction; but where a state, as a condition of a foreign corporation doing business within the state, prescribes certain regulations with regard to the transfers within the state, the foreign corporation must conform to such regulations and is bound thereby." Citing, *London, Paris and American Bank* v. *Aronstein*, 117 Fed. 601.

The respondent failed to conform its conduct to the statutory requirements of either Delaware or Oklahoma, as it was legally bound to do; it clearly violated these statutes, in utter disregard of the rights of its stockholders. It should therefore not be permitted to retain the shares of stock which it obtained as the result of violations of law; such retention is contrary to public policy (*McCandles* v. *Furland*, 296 U. S. 140, 162).

III.

The corporation and its president owed a fiduciary duty to all of its stockholders to protect their stock interests from unlawful transfer. As the corporation is itself a fiduciary and was the purchaser of this stock, its obligation to affect a legal purchase, not in derogation of the rights of its stockholders, was thereby greatly increased.

This Court will note from the opinion of the Circuit Court of Appeals that it refused to recognize the existence of a fiduciary relationship between the corporation and Mr. Toomey, its president, towards the stockholders whose shares of stock were thus acquired by the corporation. This refusal to adhere to a basic and controlling principal of law springs from that Court's misapprehension of this Court's opinion in *Securities and Exchange Com.* v. *Chenery Corporation*, 318 U. S. 70, and the failure to recognize the clear factual distinctions between the *Chenery*

case and this case. In the *Chenery* case there was a controversy between the stockholders and the officers of that corporation as to the right of officers to purchase preferred stock of their corporation on the open market, while plans for reorganization were before the Securities and Exchange Commission, and the consequent legal effect of such purchases as respects their right to ratable participation in the new stock. No question of fraud, secretiveness or breach of duty was involved or even intimated in that case; as a matter of fact, the Commission found that "honesty, full disclosure, and purchase at a fair price" characterized the transaction. The controlling question in the *Chenery* case turned upon the right of corporate officers to openly purchase preferred shares of the corporation and to permit such stock to be converted into stock of the reorganized company on the same basis and in the same proportion as the preferred stock held by other stockholders. It was there urged that the fiduciary duty of these officers towards their stockholders was violated by such purchases, with the result that proportionate participation with other preferred stockholders should have been denied to them. This Court held that although it would insist upon scrupulous observance of the fiduciary obligations of the officers towards the stockholders, it would not impose upon officers and directors any fiduciary duty to its stockholders which precludes them merely because they are officers and directors from buying and selling the corporation's stock. Obviously, there is not the remotest resemblance between the *Chenery* case and the case at bar, either in the facts or in the controlling rules of law, for in this case the issuing corporation by the use of an intermediary, in a secret manner and not on the open market, at a substantially lower price, in violation of the statutes of the state of its creation as well as the state of its residence, and for the obvious purpose of interfering

with and nullifying the steps which had been undertaken to procure deposits of stock for the purpose of the Mead transaction, and thereby to allow Mr. Toomey to retain control of this corporation, purchased these 2,000 shares of stock with operating capital, while it then had no reserve capital but an admitted deficit of close to $1,000,000.00.

Under the circumstances disclosed in this record, both the corporation and its president owed to their stockholders the duty of utmost fidelity, integrity and candor, which they not only ignored, but deliberately violated. The decision of the Circuit Court of Appeals, in holding that under these facts no fiduciary obligation existed towards the stockholders, runs counter to basic principles of equity jurisprudence and to an unwavering line of pronouncements to the contrary, by this Court, and many other Courts of Review.

It is a well recognized rule of law that the charter of a corporation is a contract between the corporation and the state, between the corporation and its stockholders and between the stockholders with respect to each other. This necessarily imposes an obligation on the corporation to observe all legal and statutory requirements which may affect the property rights of the stockholders. This Court held in *Pepper* v. *Litton*, 306 U. S. 295, at page 306, that a director is a fiduciary, so is a dominant or controlling stockholder or group of stockholders, and that their powers are powers in trust. In *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587, this Court said, on page 590, in discussing the obligation of a director towards his stockholders:

> "If he should be a sole director, or one of a smaller number vested with certain powers, this obligation would be still stronger, and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness."

In defining the circumstances which create the fiduciary relationship, this Court said in *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, at page 492:

> "It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation."

In the *Restatement of the Law of Trusts*, Chapter 7 Sec. 170, page 432, the pertinent rule is stated as follows:

> "The trustee violates his duty to the beneficiary not only where he purchases trust property for himself individually, but also where he has a personal interest in the purchase of such a substantial nature that it might affect his judgment in making the sale."

A few of the many authorities supporting these rules are the following:

Wardell v. *R. R. Co.*, 103 U. S. 651 at page 658.

McCandles v. *Furland*, 296 U. S. 140, at page 162 (80 L. Ed. 121, 56 S. Ct. 41).

Holly Corporation v. *Wilson*, 101 Col. 513, page 519.

Hinckley v. *Sac Oil & Pipe Line Co.*, 132 Ia. 396 at pages 403, 404 (107 N. W. 69).

Wool Growers Service Corporation v. *Ragan*, 140 P. (2d) 512 at page 527 (18 Wash. (2d) 655).

Farwell v. *Pyle National Headlight Co.*, 280 Ill. 157 at page 164.

Dixmoor Golf Club v. *Evans*, 325 Ill. 612, at page 616.

Billings v. *Shaw*, 209 N. Y., 265 at page 282.

Oliver v. *Oliver*, 118 Ga. 362, at pages 367, 370, 371.

Allman v. *Salem Building Association*, 275 Ill. 336 at page 341.

Fletcher Cyclopedia Corporation, Vol. 12 Sec. 5539, at page 455.

IV.

This purchase of stock cannot be defended under the provisions of the Illinois Uniform Stock Transfer Act.

If the statutes and rules of law hereinabove cited had not been urged or relied upon, the sale of this stock could still have been challenged and could have been voided, and the shares of stock would be recoverable by the defrauded stockholders; this right of recovery stems from the prevailing common law rule which protects the true owner of stock from loss thereof by theft, even though the shares of stock were found in the hands of a bonda fide purchaser. The state of Oklahoma has not adopted the Uniform Stock Transfer Act and therefore, the common law rule applies to stock purchases in that state. Obviously, the Uniform Stock Transfer Act can have no extraterritorial application, and the decision in *United States Gypsum Co.* v. *Faroll,* 296 Ill. App. 47, which is based upon that Act, and is relied upon by the Circuit Court of Appeals in its decision, is wholly inapplicable and is no authority in this case. The correct rule is stated by the Supreme Court of Massachusetts in *Barstow* v. *City Trust Co.,* 216 Mass. 330, as follows, on page 333:

> "A certificate of stock issued by a corporation with a form of assignment and power of attorney to make the necessary transfer printed on the back, which has been signed in blank by the owner, is not at common law a negotiable instrument, title to which passes by delivery. If obtained feloniously from the true owner, his title ordinarily is not divested upon sale by the thief to a purchaser for value without notice of the theft."

In *American Surety Co.* v. *Cunningham,* 200 Minn. 566, the Court said on page 574:

> "The law of the situs of a stock certificate at the time of its transfer determines the rights of the parties to it. [Citing cases.] Where the situs of the stock certificates at the time of transfer is another

jurisdiction and no proof is made at the trial as to the law of that jurisdiction, the common law rule applies * * *."

"But the common law rule applies in any case, whether or not the Uniform Stock Transfer Act is in effect in the situs at the time of transfer, to stock certificates issued by a corporation organized in a state where that act has not been adopted."

In *American Surety Co. of New York* v. *Gerold*, 12 N. Y. Supp. (2d Series) 614, the Court said on page 615:

> "Since the stock is that of a corporation organized under the laws of the State of Delaware, which has not adopted the uniform stock transfer provisions of our Personal Property law § 162 *et seq.*, such action is maintainable under common law principles which protect the true owner of a stock certificate against divestment by theft followed by negotiation and transfer to a bona fide purchaser." (Citing cases.)

Even the provisions of the Illinois Uniform Stock Transfer Act would not protect this purchase, for this corporation then was not a purchaser "in good faith without notice of any facts making the transfer wrongful," as the Illinois Act requires (Sec. 422, Chapt. 32, Ill. Revised Statutes).

CONCLUSION.

It is respectfully submitted that substantial error was committed by the United States Circuit Court of Appeals for the Seventh Circuit in its consideration of this case; that the matters herein set out call for the exercise by this Court of its supervisory powers, and that to such end a writ of certiorari should be granted and this Court should review and reverse the said decision and judgment rendered by the United States Circuit Court of Appeals for the Seventh Circuit.

Respectfully submitted,

William S. Kleinman,
Counsel for Petitioner.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1946.

No. 133

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

PETITIONER'S REPLY BRIEF.

WILLIAM S. KLEINMAN,
One N. LaSalle Street,
Chicago 2, Illinois,
Counsel for Petitioner.

CHAMPLIN-SHEALY COMPANY, CHICAGO 365

INDEX.

Subject Index.

ARGUMENT.

Table of Cases Cited.

Statutes Cited.

Summary of Argument.

A.

The basic point, consistently urged by this petitioner in both lower courts, viz:—that the respondent corporation stood in a fiduciary relation towards its stockholders whose shares of stock it acquired, and was required to maintain the burden of proof of a valid purchase, in full compliance with statutory requirements, has been completely ignored by those courts, and has not been answered in the brief of respondent. This proposition presents the very heart of this case, and it was improper for the lower courts to fail to adjudicate it.

B.

The cited statute of Oklahoma was affirmatively placed in issue by the respondent when it asserted in its answer that this purchase was "effectual * * * under the pertinent laws of Oklahoma" (R. 34). This presents a proposition of law, not of evidence. The record is complete, and this Court has the power to consider all legal questions affecting the validity of this transaction.

C.

The respondent abandoned its plea of the statute of limitations at the trial, and cannot now urge it in this Court. This defense would not apply in any event, as this is an action for fraud, perpetrated by a fiduciary; the statute of limitations did not begin to run until the fraud had been discovered. Statutes of Limitations are never applied by courts of equity to protect fraud.

This action is predicated under Sections 60e (relating solely to bankrupt stockbrokers) and 70e of the Bankruptcy Act; the rights of the bankrupt's customers to assert their respective individual rights and actions for recovery is now lodged exclusively in trustees in bankruptcy, such as petitioner, in this proceeding.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1946.

No. 133

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

PETITIONER'S REPLY BRIEF.

A.

The respondent corporation as a fiduciary of its stockholders was required to maintain the burden of proof of a valid purchase, including full compliance with the quoted requirements of the statutes of Delaware and Oklahoma. This purchase was in direct violation of these statutes and is utterly void.

Counsel for respondent base their main argument (beginning on page 15) on the proposition that officers and directors of a corporation owe no fiduciary duty to the

corporation's stockholders in respect to their individual purchases of stock from the stockholders. That is not the point in this case. This case relates to a purchase by the issuing corporation of stock belonging to its stockholder. The corporation is itself a fiduciary of its stockholders. Counsel for respondent misled the Circuit Court of Appeals into deciding this case in accordance with *Securities and Exchange Commission* v. *Cheney Corp.*, 318 U. S. 80, which has no factual resemblance to this case.

We are not contesting a transaction which concerns solely a corporate officer or director acting in his individual capacity and in his own behalf, with one or more stockholders of this corporation, as the respondent would have this Court to believe, from their argument and cited cases. Our controversy concerns the right of the *issuing corporation* to acquire and retain stolen shares of stock belonging to its *stockholders,* which it purchased in disregard and in violation of its fiduciary obligation to its stockholders and in utter disregard of statutory prohibitions against any stock purchase, except under specified circumstances. Obviously, what the Circuit Court of Appeals decided was not the issue as squarely presented to that Court. The applicable prohibitions and limitations contained in the Delaware and Oklahoma Statutes, as quoted in this petitioner's main brief, relate to purchases of the corporation's stock by the issuing corporation. Those statutes place no limitations upon any purchases by the corporation's officers and directors. This purchase was made by the issuing corporation, it was inhibited from making this purchase, as was heretofore pointed out, so consequently, the purchase was utterly void. Respondent has not answered this argument, for there is no answer.

Although it is abundantly clear from this record that the purpose for this purchase was to protect Toomey's

position as president and director of the company, nevertheless the actual purchase was made by the corporation, with corporate funds, without notice to stockholders. It is unquestionable that Mr. Toomey's relations towards the stockholders was likewise fiduciary, at the time of this purchase.

Can there be a shadow of doubt that the duty of the corporation in its relations towards its stockholders in respect to the corporate property and the stock which represents the interests of the stockholders in the corporate property, was fiduciary? If that is conceded, as it must be, then it naturally follows that in a controversy between the fiduciary and the cestuis que trust, the stockholders, respecting the subject matter of the trust, the burden is on the fiduciary to establish a valid purchase; this necessarily includes proof of compliance by the fiduciary with all statutory requirements governing the purchase of the trust property, without which no valid purchase can be claimed by the fiduciary. This is a simple statement of applicable basic law which this petitioner has consistently urged, the respondent deftly avoided answering, and which the Circuit Court of Appeals utterly failed to pass upon. The error thus committed by the Circuit Court of Appeals was unavailingly called to that Court's attention in the petition for rehearing (R. 458).

In addition to the authorities quoted in petitioner's main brief, there is cited on page 22 a list of authorities supporting the rules for which petitioner contends. To be of further assistance to this Court, and to show the uniformity of the rules contended for, the following quotations from three of the cases cited should be very helpful:

Holly Corporation v. *Wilson*, 101 Col. 513, at page 519:

> "A corporation is a trustee for its stockholders, and is bound to protect their interests. It holds its prop-

erty as trustee for its stockholders. A stockholder has the right, therefore, to rely upon the fact that the corporation will preserve his right to his stock, and to presume that it will not assert an adverse claim to it."

Seymour v. *National Biscuit Co.* (C. C. A. 3), 107 F. (2d) 58, at page 63:

"* * * the law is nonetheless settled that a corporation stands in the relation of a fiduciary to its stockholder."

Allman v. *Salem Building Association,* 275 Ill. 336, on page 341:

"But a corporation is by law the custodian of the shares of its stock and clothed with power sufficient to protect the rights of everyone interested therein from unauthorized transfers, and, like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for an injury sustained by its negligence or misconduct in making transfers or cancellations of such stock."

The rule as to the burden of proof is further supported in *Franklin* v. *Mortgage Guaranty & Security Co.* (C. C. A. 9), 57 Fed. (2nd) 834, where on page 838 the Court said:

"We agree with the appellant that generally the burden of proof to show fraud is upon him who alleges it. We believe that this burden has here been amply sustained, particularly in view of the fact that, once a fiduciary relation is established, the burden rests upon the trusted agent to show full disclosure of all transactions attacked."

The foregoing quotations as respects the facts in this case indicate clearly that the District Court and the Circuit Court of Appeals failed to correctly apprehend the essential aspects of this proceeding and the rules of law applicable thereto. The trial court said in its oral decision:

"The only question for me to decide here is whether or not good faith was exercised and honesty of purpose was displayed by Mr. Toomey at the time, for and on behalf of this corporation, he acquired these 2000 shares of stock." (R. 275.)

Practically the identical phraseology was contained in the conclusions of law submitted by respondent and entered by the trial court, as follows:

"The only question for decision is whether good faith was exercised and honesty of purpose displayed by the purchaser in the acquisition of the 2000 shares." (R. 429.)

The Circuit Court of Appeals substantially approved the limitations of this finding (R. 451).

Among the conclusions of law this petitioner presented to the trial court for consideration and adoption are the following:

"8. In a controversy between the issuing corporation and its stockholders, respecting the propriety and validity of the purchase by the corporation of shares of stock belonging to the stockholders, the burden of showing fair dealing towards the stockholders is upon the corporation." (R. 423.)

and

"20. The fiduciary relationship between Midco Oil Corporation and its stockholders, having existed, as a matter of law, the burden of proving fair dealing toward said stockholders with respect to the shares of stock in question, was upon the defendant, Midco Oil Corporation. Said defendant has failed to maintain the burden of proof." (R. 425.)

The District Court erroneously failed to adopt these applicable conclusions of law and the Circuit Court of Appeals, in its decision, ignored these rules of law, limiting this aspect of its decision to a discussion of the obligation of officers and directors towards stockholders whose

stock they were purchasing. That is not the controlling point in this case. The above quoted propositions of law submitted by this respondent and which are directly applicable to the facts in this case, are still unanswered.

As heretofore pointed out, Mr. Toomey, the respondent's president, negotiated for this fraudulent purchase, but the purchase was made by the corporation, with its own funds (R. 240, 304), without the unanimous consent of the stockholders in writing, as the Oklahoma statute requires, and not with surplus funds as both the Delaware and Oklahoma statutes require; at that time the respondent's admitted deficit was close to $1,000,000.00.

The funds of the corporation which were used to purchase this stock and to perpetrate the fraud were the funds of the stockholders, held in trust by the corporation. The actual theft of these 2,000 shares by the bankrupt did not occur until *after* the receipt of the offer from Lahman, the corporation's agent and intermediary, to purchase this stock. As a matter of fact, it appears in this record that Lahman's offer to the bankrupt was made on August 31, 1937 (R. 199, 307) and that the stock was stolen for that purpose by the bankrupt on September 1, 1937, when Engel brought an additional 700 shares of this stolen stock to his bank (R. 209), ostensibly to make a further loan thereon, but actually for the purpose of having all the certificates guaranteed by the bank as to signatures, and then, simultaneously, directed the bank to forward all the certificates on the same day to the respondent's bank in Tulsa (R. 209, 381). It is highly significant that the bank's guarantees as to signatures were all placed upon these certificates on September 1, 1937 (R. 299, 301), after the receipt of the two telegrams of August 31, 1937, confirming the purchase of these 2,000 shares of stock by Mr. Lahman, respondent's agent (R. 377, 378). The im-

portance of this evidentiary matter is to point out that the respondent's agent's offer to purchase this stock was the actual inducement for the theft by the bankrupt.

If this was not a highly questionable transaction, why was it necessary for the respondent to employ an agent (who was not a stock broker) to make this purchase and to pay him $2,000.00, rather than to negotiate for itself? Why was its identity kept secret and undisclosed? Why was it necessary to deposit a secret letter of instructions with the bank in Tulsa (R. 386), and why was Mr. Toomey referred to as "Lahman's Advisor" in a telegram from the bank in Tulsa to the bank in Chicago? (R. 382) This conduct is nevertheless urged by the respondent, here and throughout this record, as a purchase "in good faith," and "in the ordinary course of business." Does not this secrecy demonstrate that the respondent knew or had reason to know that this transaction was corrupt? The transaction was so extraordinary, that on cross-examination by respondent's counsel, Mr. Engel, who had many years' experience as a stock broker and handled this transaction, said:

> "We never had a transaction like that before, if you mean about selling securities that were owed until—"
>
> * * *
>
> "That is the only transaction I ever had of that nature."
>
> * * *
>
> "The only one I was ever mixed up with." (R. 211.)

As further evidence of the secret and fraudulent nature of this transaction, the record discloses that on April 21, 1938, one Emil Soeth, who had been the owner of seven certificates of this stock for a total of 118 shares, wrote to this respondent inquiring about his stock (R. 351). The respondent replied by letter of April 26, 1938 that his

certificates were "transferred to the present owner on September 3, 1937" (R. 352). Mr. Soeth pressed his inquiry by his letter dated June 7, 1938, in which he inquired "who sold a lot of my stock without my consent" (R. 353), to which the respondent replied by letter dated June 10, 1938, in which it falsely and fraudulently said to him: "We have contacted the purchaser of your 118 shares, which you formerly owned, and find that he bought this stock from Henry Engel of Hoagland, Allum & Company, located in Chicago" (R. 353). The following questions were propounded to Mr. Toomey on the trial of this case with respect to the last mentioned letter and he made these replies:

"Q. Now, who did you contact to make that reply?
A. I did.
Q. Who did you contact?
A. I contacted the purchaser.
Q. Who is the purchaser?
A. The Midco Oil Corporation.
Q. Who wrote this letter?
A. Miss Wade.
Q. Isn't it signed 'Midco Oil Corporation'?
A. Yes, sir.
Q. Isn't that the one who was the then owner of the stock?
A. That is correct.
Q. Did you have to go outside of your office to contact the purchaser of the stock?
A. No." (R. 259.)

B.

The laws of Oklahoma were placed in issue by the respondent as an affirmative defense, which it failed to maintain. As the record is complete, this Court has inherent power to consider the cited statutes of Delaware and Oklahoma. This stock purchase cannot be valid under any theory, as it was consummated in direct violation of both of these controlling statutes.

The respondent had the inescapable burden of establishing the validity of this stock purchase as a primary duty in its defense. The respondent apparently recognized the necessity of carrying this burden at the time it prepared its answer, but thereafter it studiously avoided making the essential proof. Respondent's assertion in the Circuit Court of Appeals and in this court that the statute of Oklahoma was not in issue is an inaccurate statement. In its answer the respondent affirmatively asserted and defended this purchase as "effectual * * * under the pertinent laws of Oklahoma" (R. 34). The laws of Oklahoma were thereby directly placed in issue before the District Court and thus were properly in the record before the Circuit Court of Appeals, and are now before this Court. Respondent has nowhere in its brief denied the applicability of the statutes of Oklahoma and Delaware as cited in this petitioner's main brief; they have completely avoided answering, for, in fact, there is no answer.

The urging of the statutes of Delaware and Oklahoma is not a point of evidence but is a proposition of law, the non-observance of which nullifies the transaction in question. This stock purchase could not be valid under any theory urged by the respondent unless it made affirmative proof that it complied with these statutory requirements, which it completely failed to do.

If, in fact, this had been a new point, raised for the first time on appeal, as the respondent urges and as the Circuit Court of Appeals held (the correctness of which contention petitioner denies), nevertheless the point was of such nature that a court of review, as a matter of judicial discretion, has the power to consider. This Court, in *Langnes* v. *Green,* 282 U. S. 531, said at page 541:

> "The term 'discretion' denotes the absence of a hard and fast rule. *The Styria* v. *Morgan,* 186 U. S. 1, 9. When invoked as a guide to judicial action it means a sound discretion, that is to say, a discretion exercised not arbitrarily or wilfully, but with regard to what is right and equitable under the circumstances and the law; and directed by the reason and conscience of the judge to a just result."

A well reasoned analysis of parallel circumstances and the rules of law applicable thereto was discussed by the Supreme Court of Wisconsin in *Cappon* v. *O'Day,* 165 Wis. 486; the Court said beginning at page 490:

> "Respondent claims in his supplementary brief that, the question of the validity of the mortgage not having been raised, the record is conclusive upon this court, and for this court to now consider the question would amount to a perpetration of a gross wrong and hardship upon the plaintiff and imposition upon the trial court.
>
> We cannot agree with this contention. This court sits here to do justice between litigants. For the purpose of orderly administration and the attainment of justice certain rules are established. Any rule the enforcement of which results in a failure of justice should be carefully scrutinized and not blindly adhered to, unless the abandonment of it will work more injustice than will follow if it be adhered to. One of the rules of well nigh universal application established by courts in the administration of the law is that questions not raised and properly presented for review in the trial court will not be reviewed on appeal. 3 Corp. Jur. 689. The reason for the rule is plain. If

the question had been raised below, the situation might have been met by the opposite party by way of amendment or of additional proof. In such circumstances, therefore, for the appellate court to take up and decide on an incomplete record questions raised before it for the first time would, in many instances at least, result in great injustice, and for that reason appellate courts ordinarily decline to review questions raised for the first time in the appellate court. But to this rule there are many exceptions. Questions as to the jurisdiction of the court may be raised. *Telford* v. *Ashland,* 100 Wis. 238, 75 N. W. 1006. Questions as to the legal effect of a deed or other instrument may be raised for the first time in this court. *Hartung* v. *Witte,* 59 Wis. 285, 18 N. W. 175; *Nightingale* v. *Barens,* 47 Wis. 389, 2 N. W. 767. There are numerous other exceptions. 3 Corp. Jur. 740. No question of the power of this court is involved. Whether this court should review a question raised here for the first time depends upon the facts and circumstances disclosed by the particular record. It undoubtedly has the power, but ordinarily will not exercise it. The question is one of administration, not of power. The statements in *Will of Brandon,* 164 Wis. 387, 160 N. W. 177, and *Ritter* v. *Ritter,* 100 Wis. 468, 76 N. W. 347, to the effect that questions not brought up in the court below cannot be considered here, must be considered as statements of the general rule to which there are exceptions as here indicated.

In this case the question as to the validity of the mortgage has been fully argued. It is not claimed that the facts do not fully appear. The record is complete."

Likewise in this case, the record is complete; the rules of law urged by this petitioner are applicable, controlling and conclusive.

C.

The plea of the statute of limitations was heretofore abandoned by the respondent and cannot now be urged. In fraud actions, the statute of limitations does not begin to run until after discovery of the fraud. In an equity action such as this, against a defrauding fiduciary, courts of equity recognize no statute of limitations where its enforcement would tend to assist in protecting the fraud.

The plea of the statute of limitations was completely abandoned by the respondent at the trial of this case. Nowhere in the conclusions of law was the District Court asked to rule upon this point. What the "court could have found" as suggested on page 21 of respondent's brief is not open to conjecture. The respondent then urged the court to find as a matter of law, and the court did find that:

> "The only question for decision is whether good faith was exercised and honesty of purpose displayed by the purchaser in the acquisition of the 2,000 shares." (R. 429.)

Had this question still been an open one, the pronouncement by this Court in *Herget* v. *Central National Bank & Trust Company of Peoria,* 324 U. S. 4, cited by respondent on page 21, would not apply, as this Court there had under consideration a suit for the recovery of a preferential transfer under Section 60 of the Bankruptcy Act. This action is grounded on Sections 60e and 70e of the Bankruptcy Act (R. 9). Neither of those sections were discussed in the *Herget* case. Section 60e, which was enacted under the Act of June 22, 1938 and became effective as part of the Bankrutcy Act on September 22, 1938, relates solely to liquidation of bankrupt stockbrokers. None

of the prior bankruptcy acts contained the provisions of Section 60e. The rights which individual customers of bankrupt stockbrokers theretofore had, to enforce their respective claims separately, in their own right, is now lodged solely in trustees in bankruptcy, such as the petitioner in this proceeding. Under paragraph 2 of said Section 60e it is provided:

> "All property at any time received, acquired, or held by a stockbroker from or for the account of customers, except cash customers who are able to identify specifically their property in the manner prescribed in paragraph (4) of this subdivision, and the proceeds of all customers' property rightfully transferred or unlawfully converted by the stockbroker, shall constitute a single and separate fund; and all customers except such cash customers shall constitute a single and separate class of creditors, entitled to share ratably in such fund on the basis of their respective net equities as of the date of bankruptcy. * * *"

Paragraph 5 of said Section 60e provides, in part:

> "* * * a transfer by a stockbroker of any property which, except for such transfer, would have been a part of such fund, may be recovered by the trustee for the benefit of such fund, if such transfer is voidable or void under the provisions of this Act."

Section 70e, which is the "Voidable Transfer" provision of the Bankruptcy Act, provides:

> "(1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

It will therefore be observed that Sections 60e and 70e relate to the manner of enforcing *existing rights and lia-*

bilities. What this Court determined in the *Herget* case was an action under Section 60, where, as this Court said:

> "* * * the federal Bankruptcy Act created the liability * * *."

It is admitted in this record that the respondent did not inform its stockholders of this purchase, either before or after its consummation. It is equally apparent from the correspondence between the respondent and Mr. Soeth, one of its sotckholders, heretofore alluded to, that the respondent fraudulently concealed from the stockholders the fact of this purchase. The averment in petitioner's complaint that the information which established the existence of this cause of action came to the attention of petitioner subsequent to the filing of the original complaint herein (R. 9), has not been contradicted. Under these circumstances, the applicable section of the Illinois statute of limitations (Chapter 83, Ill. Rev. Stat. 1945) is as follows:

> "23, Fraudulent concealment. Sec. 22. If a person liable to an action fraudulently conceals the cause of such action from the knowledge of the person entitled thereto, the action may be commenced at any time within five years after the person entitled to bring the same discovers that he has such cause of action, and not afterwards."

The Oklahoma Statute of Limitations (Title 12, Sec. 93, third paragraph) similarly provides that in:

> "* * * an action for relief on the ground of fraud —the cause of action in such case shall not be deemed to have accrued until the discovery of the fraud."

The Supreme Court of Illinois discussed the proper application of the Statute of Limitation in *Gillett* v. *Wiley*, 126 Ill. 310, where on page 328 the court says:

> "In cases of fraud, the limitations will begin to run only from the discovery of the fraud, or from the time

when the fraud could have been discovered by the exercise of reasonable diligence; but it is well settled, that the failure to use such diligence may be excused when there exists a relation of trust and confidence between the parties, rendering it the duty of the party committing the fraud to disclose to the other the truth, and where it was through the acts of the former that the latter was induced to refrain from inquiry."

In *Blount* v. *Chicago Railway Equipment Co.,* 242 Ill. App. 69, at page 87, the Court said:

"On the contrary, the action is purely equitable and statutes of limitation have no application, except under circumstances that would appeal to the conscience of a court of chancery. A court of chancery does not apply such a statute ordinarily nor permit the defense of laches to be interposed in cases where a defendant has property in his hands which equitably belongs to a complainant."

In *Bates* v. *Preble,* 151 U. S. 149, at 160-161, this Court said:

"On the other hand, if the fraud itself be secret in its nature, and such that its existence cannot be readily ascertained, or if there be fiduciary relations between the parties, there need be no evidence of a fraudulent concealment other than that implied from the transaction itself."

In *Bailey* v. *Glover,* 21 Wall. (88 U. S.) 342, this Court said at page 349:

"To hold that by concealing a fraud, or by committing a fraud in a manner that it concealed itself until such time as the party committing it could plead the statute of limitations to protect it, is to make the law which was designed to prevent fraud the means by which it is made successful."

Conclusion.

Compliance by respondent with the controlling statutes of Oklahoma and Delaware, or of either of those states, and a semblance of regard for the rights of its stockholders, would have prevented the perpetration of this fraud. That the respondent corporation violated these statutes has not been denied in respondent's brief, nor can it be successfully denied. The respondent failed to maintain its burden of proof of a valid purchase in bar of its stockholders' rights to a recovery in this cause. As this purchase is in violation of the statutes and fixed equitable principals, it cannot be upheld as valid under any theory of law, for it is forever void; the District Court and the Circuit Court of Appeals erred in failing to so hold.

This petitioner respectfully urges this Honorable Court to issue its writ of certiorari as prayed, and to ultimately reverse the judgment in this cause.

Respectfully submitted,

WILLIAM S. KLEINMAN,
Counsel for Petitioner.

FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, [illegible]

No. 123

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

RESPONDENT'S BRIEF OPPOSING PETITION FOR THE WRIT OF CERTIORARI.

SAMUEL A. BOORSTEIN
Mayo Building,
Tulsa, Oklahoma;

M. K. HOBBS
209 S. La Salle Street
Chicago 4, Illinois;

CARL HOPPE
209 S. La Salle Street
Chicago 4, Illinois,

Counsel for Respondent.

THE TWENTIETH CENTURY PRESS, INC., CHICAGO

INDEX

Table of Cases

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

No. 133

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,

Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,

Respondent.

RESPONDENT'S BRIEF OPPOSING PETITION FOR THE WRIT OF CERTIORARI.

INTRODUCTION.

The suit in which the writ is prayed is an ordinary action to recover from respondent the value of shares of its capital stock which it purchased for its treasury from a recognized broker of the stock who subsequently became bankrupt, but which stock it is claimed was fraudulently secured from the bankrupt's customers. (Decision of District Court, R. 275; Opinion of C.C.A., R. 447).

The issue is whether the respondent is a purchaser for value, in good faith, and without notice of admittedly properly indorsed and guaranteed street certificates. Both courts below held that the respondent secured good title, the reviewing court (R. 451) concurring in the special findings of the trial court (R. 486). The controlling rules of law are definitely established, and were properly applied

by the trial and reviewing courts upon such concurred findings.

It is significant that in the presentation of the petition and supporting brief, the petitioner asserts twelve "Questions Presented" (Pet'n. 7-9); specifies nine items in "Specification of Errors" (Br. 12-13); suggests five "Reasons Relied On for The Allowance of the Writ" (Pet'n. 9-10); and has four points of "Argument" (Br. 13-24). The generalities of "Questions Presented" and of the "Specification of Errors", and the lack of relationship and consistency between them and between them and the "Reasons" and "Argument" urged for allowance, demonstrates that petitioner has no crystallized conception of his disagreement with the coinciding decisions and findings below. He merely complains.

Of the four points of Argument, Points I and II relate to an issue not pleaded, upon which no evidence was adduced, which the trial court was not asked to decide (Pltf's Submitted Findings, etc. R. 414, et seq.) and did not decide, and which issue was sought to be injected for the first time on appeal (R. 449), but without assignment of error (R. 432). Points III and IV of the Argument were properly decided below.

Even had the contentions raised in Points I to IV been decided as petitioner wishes, there would have been no difference in the result.

There is not presented any conflict of decisions, any question of general interest, nor any issue of special or unusual importance.

RESPONDENT'S STATEMENT OF THE MATTER INVOLVED.

Petitioner has a five page "Statement of the Matter Involved" (Pet'n. 2-7). Essentially all of page 2 and the entire page 3 is a summary of what "is charged in the

supplemental complaint". Half of page 4 is devoted to discussion of the answer.

Of the digest of the complaint and answer, respondent has no comment save that:

(1) The decisions below were based on special findings of fact (R. 426, et seq.) approved by the appellate court (R. 451) and not upon what "is charged in the supplemental complaint"; and

(2) It is revealed in petitioner's own summary that the charge that respondent's purchase was an act in excess of statutory authority, a point now principally relied upon, is conspicuously absent.

Such contention (see Points I and II of petitioner's argument) was not even urged in petitioner's assignment of errors to the appellate court (R. 432-4). Nor did petitioner seek any finding in the trial court on the now-attempted issue (R. 414-426). Obviously the District Court could have made no finding in respect to respondent's power to purchase, for no evidence was adduced on the point, or could have been adduced under the pleadings.

Petitioner states (Pet'n. 4), that the stock purchase was made "substantially in the manner as charged in the complaint." **Each of the lower tribunals held exactly to contrary**, as will be shown very shortly.

Of the intermediary, Lahman, in the purchase transaction two erroneous statements are made. His letter transmitting the purchase price (R. 386) and asking to be notified upon the arrival of the certificates is called "secret" (Pet'n. 4). It was no more secret than any other paper or record, either of the Fourth National Bank of Tulsa, or of The Northern Trust Company, all of which were produced. Again Lahman is referred to as "respondent's intermediary" (Pet'n. 5). Lahman was directed by Engel of the bankrupt to offer the stock for sale (R. 279, 448).

The Circuit Court of Appeals is charged with not reviewing the record (Pet'n. 6). That Court said it did examine the record (R. 451).

The observations, (Pet'n. 6) that consent of stockholders for the purchase was not secured and that respondent's capital was impaired, were not and are not in issue. No allegations are found in the complaint (R. 9-14) even suggesting, much less raising, such an issue. The trial was completely barren of any such point, as shown by the pleadings (R. 9-14, 30-35), the evidence, the decision (R. 274), the petitioner's proposed findings (R-414-422), the findings entered (R. 426), and appellant's statement of points on appeal (R. 432-434).

The "Questions Presented" (Pet'n. 7) and the "Specification of Errors" (Br. 12) do not utter a word challenging the findings of fact of the District Court (R. 426). This impartial, judicial statement is therefore referred to for a concise statement of the facts. From the findings it is clear that petitioner's statement that the stock was purchased "substantially in the manner as charged in the supplemental complaint" is most inaccurate. The Court, in brief, made the following numbered findings:

3. Hoagland and Allum was adjudicated bankrupt on or about April 14, 1938 (R. 426, 449).

4. On September 3, 1937, Hoagland and Allum, or its officers, Engel or Larsen, sold 2,000 shares of capital stock of Midco (respondent) to Midco. This stock, except 125 shares owned by Engel, belonged to customers who had deposited with Hoagland and Allum their respective certificates endorsed in blank with their signatures guaranteed. None of the proceeds of the sale ever came to the customers (R. 426-7, 448).

6. In April, 1937, Hoagland and Allum, with proxies, tried to oust from control of Midco, its president, Toomey.

There had been a bitter dispute over control of that corporation (R. 427).

7. In July, 1937, a stockholders' committee organized by Hoagland and Allum circularized Midco stockholders to deposit with the First National Bank of Tulsa, their certificates of stock "for offer of sale to Roy Mead at $43 a share in the event not less than 51% of the total outstanding stock of Midco be so deposited" (R. 427, 448).

8. After receiving a number of letters from stockholders inquiring about the Mead proposal, Toomey circularized all stockholders in an endeavor to prevent the deposit and a sale to Mead (R. 427).

9. Certificates for 1971 shares (less than 51%) were deposited with the First National Bank of Tulsa between Aug. 2, 1937 and Oct. 27, 1937. All such stock was returned to depositors. None of the deposited stock was among the 2,000 shares purchased by Midco on September 3, 1937 (R. 427, 448).

10. Lahman, a broker in Tulsa, discussed with Toomey the acquisition of the stock in dispute (R. 428, 448). Lahman was requested by Engel of the bankrupt to sell the stock (R. 448).

11. Larsen of Hoagland & Allum discussed the proposed sale with Lahman. "His testimony did not have to do with the instability or insolvency of Hoagland & Allum." Larsen did not want Toomey to acquire the stock but was overruled by the management of Hoagland & Allum (R. 428).

12. The directors of Midco authorized the purchase (R. 428, 448).

13. The stock certificates eventually purchased by Midco were pledged by Engel with The Northern Trust Company of Chicago in support of his personal note for about

$50,000. Fourteen hundred shares so pledged and so sold were registered in Engel's name (R. 428, 448). "All of the pledged certificates were endorsed in blank by the registered holders with their respective signatures guaranteed by a brokerage house or bank" (R. 429, 448).

14. The sale was closed out through The Northern Trust Company, which transmitted the stock to Tulsa. The signatures of endorsement were each guaranteed by The Northern Trust Company. The stock was inspected and accepted by Toomey; the certificates cancelled, and a new certificate issued to Midco (R. 429, 448-9).

15. The price paid was a fair price and did not indicate any notice or knowledge of any infirmities (R. 429, 451).

16. Neither Toomey nor Midco nor any agent thereof had notice or knowledge that the stock which was purchased may have been held by Hoagland & Allum for any purpose other than sale in the regular course of business, or that the stock had been wrongfully converted (R. 429, 451).

17. There is no evidence in this case which indicates that Toomey or any agent of Midco had any notice or knowledge of any kind that there was any imperfection in connection with the manner in which this stock was held by The Northern Trust Company or being acquired by the Midco. There is nothing in the testimony which indicates Midco was not a purchaser for value, and there is nothing here which indicates it did not act in good faith (R. 429, 451).

The Circuit Court of Appeals "examined the record" and was "convinced there was substantial evidence upon which to base these findings" (R. 451).

At the bottom of page 20 of his brief, petitioner argues that the purchase was

a. "in a secret manner." The trial court was asked so to conclude. It refused (Refused Conclusion 4, R. 422).

b. "by the use of an intermediary (of) the issuing corporation." The trial court refused to find that Toomey directed Lahman. (Refused Finding 18, R. 418). The Circuit Court of Appeals found that it was Engel of Hoagland and Allum who requested Lahman to approach Toomey (R. 448).

c. "in violation of the statutes." Petitioner did not even ask the Court to make such finding (R. 414-426). It was not in issue.

d. "for the purpose of interfering with and nullifying" the Mead transaction. The Court refused so to find. (Submitted Finding 17, R. 417).

e. "at a substantially lower price." The Court found the price paid "was a fair price" (R. 429, 451). The price paid was $33.50 per share whereas the market value of the stock at the time of the purchase was from $29 to $32 a share (R. 266).

f. "not on the open market." The purchase was in the regular course of business. Hoagland and Allum was the house of issue of Midco stock (R. 140) and the recognized market for the stock (R. 145, 447-448). Lahman was informed by Hoagland and Allum that it was dealing in the stock all the time and always had 3,000, 4,000 or 5,000 shares on hand (R. 164-165).

The imputations, inferences and innuendos appearing throughout the petition and brief are as ill-founded on the record and the findings of both courts as those specifically refuted above in paragraphs (a) through (f).

SUMMARY OF ARGUMENT.

In answer to petitioner's four points of argument, respondent contends in similarly numbered points:

I.

The Circuit Court of Appeals did not refuse to take judicial notice of the statutes of Delaware and of Oklahoma relative to the purchase of its capital stock by an issuing corporation. The Court did take judicial notice of pertinent statutes called into issue by the pleadings and the evidence.

The statutes in question were not pertinent to the appeal.

II.

Whether the purchase of its own stock by the respondent was *ultra vires* is not in issue. The point was not and could not have been litigated under the pleadings.

It is a cardinal principle that an issue cannot be raised for the first time on an appeal.

Even if it be assumed that the stock purchase was *ultra vires,* the result would not be changed. The claim of *ultra vires* is not pertinent to overcome the defense of bona fide purchaser for value without notice. There is no causal relationship, as this Court has held in *Hubbard, assignee* v. *Tod,* 171 U. S. 474, 502, between an act in excess of power and notice of infirmities in title to securities.

III.

Corporate officers have trust obligations in respect to the property and business of the corporation but the trustee relationship does not extend to a stockholder in respect to his individual stock certificates, over which officers have no control. *Securities & Exchange Commission* v. *Chenery Corporation et al,* 318 U. S. 80.

The additional scrutiny, which petitioner thinks is demanded by a trust obligation which does not exist, would have made no change in the findings. The Circuit Court of Appeals examined the record with this supposed rule

in mind and stated that nonetheless it agreed with the findings which the trial court made (R. 449).

IV.

The respondent took good title to the stock either under the Uniform Stock Transfer Act of Illinois, the laws of Oklahoma, or the laws of Delaware.

V.

Additionally the respondent argues that the petitioner's action is barred by the statute of limitations.

The respondent's argument is directed to such of the issues raised by the petition and brief which the petitioner argues. Respondent does not reply to questions raised which the petitioner did not deem important enough to cover in his argument.

ARGUMENT.

I.

The Circuit Court of Appeals Did Not Refuse to Take Judicial Notice of the Statutes of Delaware and of Oklahoma. It Said the Statutes Were Not Pertinent to the Appeal.

The Circuit Court of Appeals in its opinion manifested no reluctance to accept the printed version of the statutes of Oklahoma or of Delaware without proof. Indeed, in its opinion (R. 450), that Court cited and quoted one Oklahoma statute. It also, on the same page, referred to the Uniform Stock Transfer Act.

The reason that the Court did not consider the sections of the Delaware and Oklahoma statutes which to petitioner seem pertinent was expressed by the Circuit Court of Appeals in part in the following language:

"But no claim was made before the trial court, nor was the case tried upon the theory that the purchase of the stock was in violation of the statutes, and the point is raised for the first time on this appeal" (R. 449).

Additionally, the Court was not asked to consider the Delaware statute. It appears for the first time in the petition for the writ.

The Circuit Court of Appeals was voicing what this Court said in *Adams* v. *Saenger,* 303 U. S. 59, 63, cited by petitioner, viz., judicial notice would be taken of the laws of the several states,

"where they are in issue".*

Petitioner does not complain that the District Court did not take judicial notice of the statutes for the obvious reason that petitioner did nothing by way of complaint, offer of evidence, or calling the statutes to the attention of that Court.

II.

Whether the Purchase of Stock was Ultra Vires is not In Issue.

Petitioner's Point II of Argument is fallacious on two grounds. *First,* the point has not been litigated, and could not have been litigated under the pleadings framed by petitioner. *Second,* it is assumed by petitioner that if the Court of Appeals had found that it was an issue and that the purchase was made without corporate authority, it necessarily must have reversed.

*It is well settled that when anyone seeks the benefit of a statute or to enforce a statutory right or liability, he must by allegation and proof bring himself clearly within its provisions. *Touhey* v. *Decatur,* 175 Ind. 98, 102, 32 L. R. A. (N. S.) 350, 355.

IT IS A CARDINAL PRINCIPAL THAT AN ISSUE CANNOT BE RAISED FOR THE FIRST TIME ON APPEAL

The reason for such a rule is obvious. To be fair to the opponent and the court, a litigant must "fairly acquaint the trial court with all matters relied upon". *Maloney* v. *Brandt,* 123 F. (2d) 779, 782, C.C.A. 7.

The supplemental complaint is barren of any fact allegation even remotely suggesting lack of authority to purchase or statutory violation in the purchase (R. 9).

The record of the evidence shows that the issue was not tried by the express or implied consent of the parties, as perhaps might have been done under Rule 15(b),—Rules of Civil Procedure.

The petitioner himself cannot believe the issue was tried for he submitted no findings or conclusions addressed to or collateral to such a point (R. 414, et. seq.).

The statement of points to be urged on appeal is equally silent (R. 432-4), though Rule 9 of the Circuit Court of Appeals of the Seventh Circuit requires that an appellant "shall set out separately and particularly each error asserted and intended to be urged".

The result of petitioner's point II is that the Circuit Court of Appeals is asserted to be erroneous because it did not reverse the trial court for failure to find something that the trial court was not asked even to find and for failure to determine an issue not before it.

Clearly, the petition for the writ should be denied under the doctrine of *McCullough* v. *Kammerer Corp. et al.,* 323 U. S. 327, in which this Court dismissed the writ of certiorari upon discovery that the question on which it was granted was neither raised, litigated, nor passed on below.

That courts do not determine issues attempted to be raised for the first time on appeal is ruled in the following decisions:

Denver Stock Yard Co. v. *U. S.,* 304 U. S. 470, 485

Becker Co. v. *Cummings,* 296 U. S. 74, 80

Denver v. *Denver Union Water Co.,* 246 U. S. 178, 185

Virtue v. *Creamery Package Mfg. Co.,* 227 U. S. 8, 38

EVEN IF IT BE ASSUMED THAT THE STOCK PURCHASE WAS ULTRA VIRES, THE RESULT WOULD NOT BE CHANGED.

There is no causal relationship between want of statutory authority and the question of good faith. The unfortunate loss by Hoagland & Allum customers was due to their misplaced confidence in placing their property, clothed with all the indicia of title, and dressed for "street" sale in the hands of unscrupulous men. *Ultra vires* would not create nor aggravate their loss; and *intra vires* would not relieve it.

The Supreme Court applied this rule in *Hubbard, Assignee,* v. *Tod,* 171 U. S. 474. In this case one Garretson, head of a railroad and bridge building syndicate, delivered his notes to Hubbard's assignor, Union Loan and Trust Company, upon the understanding that he, Garretson, would deliver to the trust company the collateral sought to be recovered in the suit from the defendant who claimed to be a *bona fide* purchaser for value (p. 475-6).

However, without any authority from Union Loan and Trust Company, Garretson caused the shares of stock and the bonds in question to be vested in Pacific Short Line Bridge Company and took back a note for $1,500,000 pledged by said stock and bonds (171 U. S. 477-478). Gar-

retson then transferred the said note and the shares of stock and bonds to the banking firm of J. Kennedy Tod & Co. of New York as collateral security for a loan to Garretson. Tod & Co. foreclosed the $1,500,000 note and bought in the collateral stock and bonds for $1,000,000 (171 U. S. 478). Hubbard, Assignee, then brought action against Tod & Co. praying for an injunction against the disposition of said stock and bonds and for a surrender by Tod to Hubbard of the collateral. Hubbard asserted that Tod & Co. was not a bona fide purchaser for value, in good faith, and without notice because the transaction by which Tod & Co. took the shares of stock as collateral security involved usurious rates of interest, and secondly, because the acquisition and pledging of the stock and bonds by Pacific Short Line Bridge Company was an *ultra vires* transaction.

This Court made several observations. The first agreed with the decision of the Circuit Court that Hubbard, in order to secure any relief in equity, would be compelled to pay the sums advanced and interest, refusing equitable relief because Hubbard had not tendered or made any offer of payment. This Court held that one who seeks the affirmative aid of equity can only do so by doing equity himself (171 U. S. 501, 502). The same observation may be made as to petitioner here, who has not offered to return the $67,000 which the Midco Oil Corporation in good faith paid for said 2,000 shares of its capital stock.

This Court next treated the defense that the transaction with the Bridge Company was *ultra vires,* and with respect to this contention, it held (p. 502):

> "**** there was nothing in the invalidity of the action of the Bridge Company which gave the Trust Company any greater right to the securities than it had before. **** the Trust Company could not avail itself, in favor of its own alleged claim, of such an infirmity, if it existed, nor could the holders of the

notes, which had passed into their hands as strangers, be deprived of the securities on the faith of which they had advanced their money; ****."

The Court next considered the analogous defense that the alleged usurious character of the contract, and its invalidity for lack of power in the Bridge Company, so took the transaction out of the ordinary course of business as to charge Tod & Co. and the loan holders with bad faith and notice of the alleged claims of the Trust Company (171 U. S. 502, 503). As to this contention the Supreme Court held:

> "**But we cannot perceive that the fact of usury between the parties to the contract, if usury there were, or action in excess of power, if that existed, either or both, can be laid hold of to justify the imputation of notice that Garretson was dealing with the securities in derogation of rights of the Trust Company.** Doubtless there are cases where commercial paper or securities may be offered for negotiation under circumstances so out of the usual course of business as to throw such grave suspicion on the source of title that lack of inquiry, assuming that it would disclose defects, might amount to culpable negligence. But that doctrine has no application here."

At p. 504, the Court continued:

> "If the transactions, thus briefly stated, were unaffected by notice of any want of authority in Garretson in respect of the Trust Company as now alleged, it is not for that company to say that Tod & Co., or the holders of the loan, should be held chargeable with notice simply because the commissions and options might have constituted usury as between the parties to the loan, or the Bridge Company, its stockholders, or judgment creditors might have had cause of complaint of defect of power."

By way of recapitulation as to Grounds I and II of the petitioner's argument, the respondent submits that there is no question which warrants the grant of the petition for the writ of certiorari. The question was not raised by the pleadings and was not litigated in the trial court; and even if it had been so litigated, a claim of *ultra vires* is not pertinent to overcome a defense that a purchaser of shares of capital stock is a bona fide purchaser for value without notice of infirmities in the title of such stock.

III.

Fiduciary Obligations of Corporate Officers in Respect to Corporate Property and Affairs Do Not Extend to Trust Duties In Respect to a Stockholder's Property, Over which the Corporation and Its Officers Have No Control.

As petitioner states his point III (Br. 19), Toomey and Midco owed a fiduciary obligation to the customers of Hoagland & Allum to protect them against the embezzlement of their stock by Hoagland & Allum, and its subsequent transfer to an innocent purchaser for value.

Even if such a rule as that proposed existed, it would have no application, in view of the concurring findings of the trial and appellate tribunals. The price was fair (R. 429, 451). There was no knowledge or notice of any infirmities (R. 429, 451). There was no knowledge or notice that Hoagland & Allum had the stock for any purpose other than sale in the regular course of business (R. 429, 451).

The Circuit Court of Appeals said (R. 449):

> "The argument is, that had the trial court been mindful of the rule, it would not have made the findings it did make. With this argument we cannot agree . . . ".

Here it is pertinent to observe that this Court in *United States* v. *Clark*, 200 U. S. 601, 608, applied the principle

that where both courts below concur on the question of bona fide purchaser their findings of fact will not be disturbed.

But the Circuit Court of Appeals correctly said there is no rule that a corporate officer has trust obligations in respect to the individual holdings of a stockholder, over which the officer has no control (R. 450). Petitioner voices no criticism of the cases relied upon by the Circuit Court of Appeals distinguishing between fiduciary obligations in respect to corporate property and business and the private personal stockholdings of shareholders, except to attempt a distinction in fact between the circumstances in *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U. S. 80 and the record in the instant case.

In the *Chenery* case, the fact finding tribunal found that "honesty, full disclosure, and purchase at a fair price" were present (p. 86). In the instant case the trial court found that "good faith was exercised and honesty of purpose was displayed" (R. 275) and that a "fair price" was paid for the stock (R. 429).

This Court held in the *Chenery* case, as the reviewing court held in the instant case that

> "*** the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock" (p. 88).

An examination of the three decisions* discussed by petitioner at pp. 21 and 22 of his brief discloses that none of them deals with acquisition of shares of stock, but instead involves property belonging to the corporation.

**Pepper* v. *Litton*, 308 U. S. 295.
Twin-Lick Oil Co. v. *Marbury*, 91 U. S. 587.
Southern Pacific Co. v. *Bogert*, 250 U. S. 483.

The law is clear that a director may deal with an individual stockholder and purchase his stock on practically the same terms as a stranger.

> *Hooker* v. *Midland Steel Company,* et al, 215 Ill. 444;
>
> *Bawden* v. *Taylor et al.,* 254 Ill. 464;
>
> *Capitol Hill Undertaking Co.* v. *Render,* 299 Pac. 854 (Okla. 1931).

The doctrine is applicable to Delaware corporations, as shown by *Dupont* v. *Dupont* (D.C. Del. 1917), 242 Fed. 98, 136, cited with approval in *Cahall* v. *Lofland* (Ct. of Chancery Del. 1921), 12 Del. Ch. 299, 305-306; 114 Atl. 224, 228, as follows:

> "(5) The duties of a director or other officer of a corporation in transactions where he is representing his company are governed by well-established and familiar rules of equity. A director of a corporation may freely purchase its stock, and occupies no relation of trust to an individual stockholder which prohibits his using whatever advantage his position may afford him through knowledge of its business and condition superior to that of the stockholder with whom he deals. He is not accountable to the stockholder for withholding information from him which affects the value of the stock, but to the corporation, the whole body of stockholders, he stands in a fiduciary relation which requires him to exercise the utmost good faith in managing the business affairs of the company with a view to promote, not his own interests, but the common interests, and he cannot directly or indirectly derive any personal benefit or advantage by reason of his position distinct from the co-shareholders." (p. 136)

It is in connection with the *Chenery* case that petitioner makes his unfounded observations as to secrecy, ulterior

purpose, inadequate price, etc. (Br. 20) which statements were considered seriatim herein, page 7.

Petitioner's point III does not justify the writ. The rule contended for does not exist; the *Chenery* case was correctly applied below; the additional scrutiny which petitioner thinks is demanded by a non-existent rule would have made no change in the findings (R. 449).

IV.

Respondent Took Good Title Under All Appilcable Authorities.

The petitioner's point IV is that the transfer may not be defended under the Illinois Uniform Stock Transfer Act because the States of Oklahoma and Delaware had not adopted the Uniform Transfer Act; but in support of his position, there are cited a Massachusetts case, a Minnesota case, and a New York case.

In consideration of this question, it should be observed that both the trial court and the Circuit Court of Appeals found that the stock certificates in question were endorsed in blank and were deposited by the certificate holders with Hoagland & Allum Co., Inc., and that the respondent purchased such certificates for value from Hoagland & Allum Co., Inc., in good faith and without any notice of any alleged infirmities in the title to such street certificates. Whatever may have been the law in Massachusetts, Minnesota, and New York, assuming that the petitioner has properly stated such law, there is no question that upon these fact findings that the transfer is valid.

It is valid under the law of Illinois, if the law of that state is applicable, because Illinois has adopted the Uniform Stock Transfer Act which petitioner concedes would pass good title to a bona fide purchaser for value and without notice.

It is valid under the laws of Oklahoma, if the laws of that state apply, and under the laws of Delaware (the state of incorporation), because Oklahoma treats stock certificates in street form in much the same manner as negotiable instruments and because Delaware applies the principle of estoppel against a certificate holder who endorses his stock certificates and gives them to another person.

The Oklahoma law is properly set forth in the opinion of the Circuit Court of Appeals (R. 450-451) as follows:

> "An Oklahoma Statute, 1941, Title 18, § 56 provides: '*** shares of stock are personal property, and may be transferred by endorsement by the signature of the proprietor, *** and delivery of the certificate; ***' In the case of *First National Bank* v. *Stribling* (Supreme Court of Oklahoma), 86 P. 512, 516, the court speaking of the language quoted, said: 'This language makes such shares of stock negotiable by endorsement and vests in the transferee a complete title to the paper transferred.' See also *Petty v. Knight-Petty Mercantile Co.,* 220 P. 835, 837. In the case of *Litchfield* v. *Henson Oil Co.,* 157 P. 137, 138 Oklahoma court) the court said: 'It is well known that stock certificates of all kinds have been construed in such a way that they have become the basis of commercial transactions in all the large cities in the country, and are sold in open market the same as other securities; and, whilst they are neither in the form or character of commercial paper, they approximate it as nearly as practicable.' See also *Capitol Hill Undertaking Co.* v. *Render,* 299 P. 854, and *Render* v. *Capitol Hill Undertaking Co.,* 53 P. 2d 251."

The Delaware law is to the same effect as appears from *E. I. DuPont de Nemours & Co.* v. *Laird et al* (Court of Chancery of Delaware, July 29, 1939, Decree Modified on other points on Reargument Nov. 11, 1939) 8 Atl. (2d) 162, 165-166:

> "The Uniform Stock Transfer Act has never been adopted in this State, so the determination of this

case is necessarily governed by equitable principles, and not by the provisions of that Act.

*** where the real owner of goods, chattels, or other personal property, by some act on his part, has given to another person the apparent indicia of title thereto, and, therefore, the apparent right to dispose of such property, a bona fide purchaser, or pledgee, for value from the person holding such evidence of title will be protected against the claim of the real owner.

*** where the true owner holds out another, or allows him to appear, as the owner of, or as having full power of disposition over the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected.

*** The delivery of stock certificates, endorsed in street form, usually comes within this rule, if they are sold or pledged to a bona fide purchaser for value, without notice of any defects in the title of the seller. This is not on the ground that such certificates are negotiable instruments, but on the ground of estoppel, based on the negligent or other acts of the real owner, which tend to mislead a bona fide purchaser or pledgee for value.

*** The recognition of these general principles is merely the application to particular facts of the well settled equitable rule that 'wherever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it.' "

V.

No Useful Purpose Would Be Afforded By The Grant of The Writ of Certiorari Because The Petitioner's Action Is Barred by Statute of Limitations.

This action is plainly barred by the limitation of actions imposed by Section 11 (e) (11. U. S. C. 29) of the Bankruptcy Act. That the Trustee's action is specifically barred

by the time limits imposed by the Bankruptcy Act is, of itself, sufficient reason for denying the petition for certiorari. Both the trial court and the Circuit Court of Appeals found for the respondent on the merits. Either court could have found justifiably that the action was barred and dismissed it for that reason alone.

Paragraph 4 of the Answer (R. 31) pleads the bar of statute of limitations. The petitioner's supplemental complaint states that the cause of action is founded in Sections 60 (e) and 70 (e) of the Federal Bankruptcy Act (R. 9). The complaint alleges, and the petitioner conducted the trial and review on the theory, that the transfer of the stock in question to the respondent was fraudulent, to which subject matter Section 70 (e) (11. U. S. C. 110) pertains. However, it is Section 60 (e) (11. U. S. C. 96) upon which the petitioner must rely to support his action brought on behalf of customers of a bankrupt stock broker. It is Section 60 which generates the cause of action. The petitioner was therefore bound under the provisions of Section 11 (e) of the Bankruptcy Act to institute action within two years from the date of adjudication. It is the clear and unequivocal holding of the Court in *Herget* v. *Central National Bank & Trust Company of Peoria,* 324 U. S. 4 that Section 11 (e) is clearly appropriate to an action under Section 60 and that the time limitation is two years from the date of adjudication.

Hoagland and Allum was adjudicated bankrupt April 14, 1938 (R. 426), over seven months after the purchase. This action was instituted March 26, 1943 (R. 8) nearly five years after adjudication, and over five years after the purchase.

CONCLUSION.

The decisions and judgments complained of are correct. The case turned on fact issues resolved adversely to petitioner by concurring findings. The rules of law were correctly stated and correctly applied. New issues raised for the first time in a brief on appeal may not be heard, in fairness to the Court and opponent, who are entitled to know the metes and bounds of the litigation.

No reason of policy, interest, or justice suggests or requires the granting of the writ.

Respectfully submitted,

Samuel A. Boorstin
Mayo Building,
Tulsa, Oklahoma;

M. K. Hobbs
209 South La Salle Street
Chicago 4, Illinois;

Carl Hoppe
209 South La Salle Street
Chicago 4, Illinois,

Counsel for Respondent.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1946.

No. 133

JOHN H. CHATZ, Trustee in Bankruptcy of Hoagland & Allum Co., Inc.,
Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,
Respondent.

PETITION FOR REHEARING.

WILLIAM S. KLEINMAN,
One N. LaSalle Street,
Chicago 2, Illinois,
Counsel for Petitioner.

CHAMPLIN-SHEALY COMPANY, CHICAGO 365

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1946.

No. 133

JOHN H. CHATZ, Trustee in Bankruptcy
of Hoagland & Allum Co., Inc.,
Petitioner,

vs.

MIDCO OIL CORPORATION, a corporation,
Respondent.

PETITION FOR REHEARING.

MAY IT PLEASE THE COURT:

Since the filing of the petition for certiorari in this cause, the decision of the Supreme Court of Illinois in *Winger* v. *Chicago City Bank & Trust Co.*, 394 Ill. 94, was officially published in the Advance Reports of September 11, 1946. The instant proceeding embodies a number of established equitable principles as announced by this Court and by a great number of the state supreme courts; however, the language of the Supreme Court of Illinois in the *Winger* case is clearly the strongest, and unequivocally

establishes the justice of petitioner's position as urged throughout this proceeding. The existence of a fiduciary relationship between the respondent corporation and its stockholders, as well as the wilful violation of the respondent's obligations thereunder, were consistently urged and stressed by petitioner in the lower courts.

We have throughout this proceeding insisted that as the result of the fiduciary relationship, which then existed between the corporation and the stockholders whose shares of stock the corporation illegally acquired, the burden was on the corporation to establish this purchase as valid, and that it failed to establish such validity. The Supreme Court of Illinois has held in the *Winger* case that the existence of the fiduciary relationship makes the transaction presumptively fraudulent.

The Supreme Court of Illinois said in that case at page 108:

> "They [the directors of the corporation] were the agents for the corporation in the transaction of its business. While not express trustees they were regarded, while dealing with the corporation for their own benefit, as trustees. [Citing cases.] If considered merely as agents, still the relation of principal and agent is a fiduciary one. [Citing cases.] The relation of directors of a corporation to its stockholders, towards the corporation, and in many instances towards its creditors, is a fiduciary relationship. [Citing cases.]"

On page 109 the Court said:

> "Therefore, directors of a corporation cannot acquire the property of the corporation without exercising the utmost good faith. [Citing cases.] The sale is presumptively fraudulent."

On page 110 the Court said:

> "The question is one when, as between the parties, influence is implied in the very conception of the rela-

tion, in which the position of one is superior to that of the other. It does not involve intentional concealment or misrepresentation, and while equity does not deny the possibility of valid transactions between the two parties, yet, because every fiduciary relation implies a condition of superiority held by one of the parties over the other, in every transaction between them by which the superior party obtains a possible benefit, equity raises a presumption against its validity and casts upon that party the burden of proving affirmatively its compliance with equitable requisites to overcome the presumption."

On page 113 the Court said:

> "We regard this case as one where the appellants stand in the shoes of fiduciaries who, to their own advantage, have dealt with property of their cestui que trustent without disclosure or legal confirmation of their acts. The relationship being shown by strong and unequivocal evidence, the burden of proof to establish rights in the property transferred rests upon appellants."

The record of this case established that the $65,000.00 with which Mr. Toomey, the president of Midco Oil Corporation, purchased the 2,000 shares of stock in question for the corporation came from the treasury and assets of the corporation; therefore, this money of the corporation was actually the property of the stockholders and was used by the corporation to fraudulently purchase the shares of stock belonging to these stockholders. The situation thus presented is akin to the rule announced by the Supreme Court of Wisconsin in *Huber* v. *Martin,* 127 Wisc. 412, where on page 433 the court said:

> "In a general sense, every member of a mutual corporation is a stockholder and is the equal of any other member similarly situated or any member of any corporation having an equal interest, proportionately as to holding the beneficiary title to the corporate assets. For corporate purposes only the corporate entity owns the property, otherwise it belongs to the members."

Mindful that the funds with which the purchase was made belonged to the stockholders and that these funds were used by Mr. Toomey and the corporation to fraudulently purchase their stock, the rules governing trust relationships as urged by petitioner must of necessity be enforced in this case. The error committed by the District Court and by the Circuit Court of Appeals in failing to determine the existence of the fiduciary relationship and to enforce these important rules is a matter calling for the exercise of this court's supervisory jurisdiction to the end that these errors be reviewed and corrected. When the rules herein cited are viewed in the light of the authorities urged by petitioner in his original brief as well as in petitioner's reply brief filed on August 3, 1946, this Court must inevitably come to the conclusion that the failure of the lower courts to recognize the fiduciary relationship as urged herein by petitioner and to apply the proper rules thereto is fatal to the judgment in this case and that this error justifies a review by this Court and the ultimate reversal of the judgment.

A correct determination of the petition requires the application of sound equitable principles; but basically this record presents a proposition of local law. Having reference to the precepts enunciated by this Court in Rule 38 (5b) as to the circumstances under which certiorari would be considered, we find that this is a case where the Circuit Court of Appeals "has decided an important question of local law in a way probably in conflict with applicable local decisions" and has "so far departed from the accepted and usual course of judicial proceeding, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision".

Wherefore petitioner respectfully urges this Court to reconsider and to vacate the order entered on October 14,

1946 denying the petition for certiorari; to reconsider and rehear said petition in the light of the authorities cited and to direct the issuance of a writ of certiorari as prayed.

William S. Kleinman,
Counsel for Petitioner.

State of Illinois, }
County of Cook. } ss.

I, William S. Kleinman, counsel for petitioner, do hereby certify that the foregoing petition for rehearing on behalf of said petitioner is presented in the utmost good faith and is not intended for purposes of delay.

William S. Kleinman,
Counsel for Petitioner.